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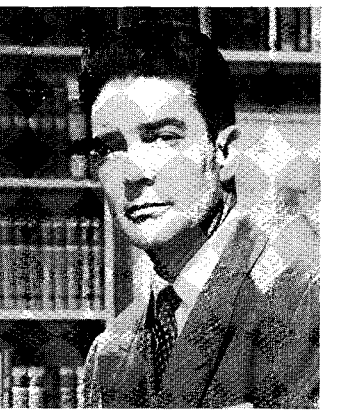

DAN SMOOT

WITHHOLDING TAX—PART III

On July 12, 1909, the Sixty-first Congress passed a resolution (whose chief sponsor was Cordell Hull, then a U. S. Representative from Tennessee) to submit, for ratification by the States, the Sixteenth (income-tax) Amendment. The U. S. Senate voted 77-0 in favor of the resolution; the House voted 317-14 for it.

On February 25, 1913, three-fourths of the states having ratified, the Sixteenth Amendment was formally proclaimed as a part of the Constitution.

Virginia was one state which never did ratify the Sixteenth Amendment, primarily because of the influence of Richard E. Byrd (father of the present Senator Harry F. Byrd). On March 3, 1910, while the Virginia legislature was considering the pending Constitutional amendment, Richard E. Byrd, then Speaker of the House of Delegates, prophesied some of the evils which a federal income tax would spawn. He said:

"It (the 16th Amendment) means that the state must give up a legitimate and long established source of revenue and yield it to the Federal government.

"It means that the state actually invites the Federal government to invade its territory, to oust its jurisdiction and to establish Federal dominion within the innermost citadel of reserved rights of the Commonwealth.

"This amendment will . . . extend the Federal power so as to reach the citizen in the ordinary business of life. A hand from Washington will be stretched out and placed upon every man's business; the eye of a Federal inspector will be in every man's counting house.

"The law will of necessity have inquisitorial features, it will provide penalties. It will create a complicated machinery.

"Under it, businessmen will be hauled into courts distant from their homes.

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"Heavy fines imposed by distant and unfamiliar tribunals will constantly menace the taxpayer.

"An army of Federal inspectors, spies and detectives will descend upon the state. They will compel men of business to show their books and disclose the secrets of their affairs. They will dictate forms of bookkeeping. They will require statements and affidavits. On the one hand the inspector can blackmail the taxpayer and on the other, he can profit by selling his secret to his competitor.

"When the Federal government gets a strangle hold on the individual businessman, state lines will exist nowhere but on the maps. Its agents will everywhere supervise the commercial life of the states. . . ."

One could fill a library with case histories which prove the accuracy of Richard E. Byrd's prophecy.

That hand from Washington reaches now into the pockets of every person in the nation. It controls and corrupts. Sometimes it is vengeful against a taxpayer who is not docile. Sometimes it plays favorites with "important" people. But always it grasps, with an ever-growing greed, trying to fill the insatiable maw of the vast, sprawling, uncontrollable bureaucracy which feeds on it.

Playing Favorites

Has the nation forgotten the books which Harry Truman and Dwight D. Eisenhower wrote? Other people pay ordinary income tax on the proceeds of what they write. Sometimes a writer struggles for years, losing money on every book, eating up his savings; and then, one year, a book succeeds and earns $100,000. The government takes most of it for income tax: no allowance for years of loss behind, or for lean years ahead.

When Truman and Eisenhower wrote books that earned hundreds of thousands of dollars, the Internal Revenue Service gave special dispensation. Eisenhower and Truman were permitted to report earnings on their books not as ordinary income but as capital gains. The legal pretext? Internal Revenue ruled that Truman and Eisenhower were not professional writers: they were amateurs.

Here are passages from an Associated Press dispatch, datelined in Detroit, and distributed October 6, 1959:

"The government settled $3,250,000 [3 million, 250 thousand] in income tax claims against 527 officers and international representatives of the United Auto Workers Union for $106,000 [106 thousand] Tuesday [October 6].

"The case had been in negotiation for more than a year. . . .

"The *Detroit Times* reported that UAW President Walter P. Reuther settled a claim of $31,000 against him for $615 and said [Emil] Mazey [Secretary-Treasurer of the UAW] paid $400 on a claim of undisclosed size. . . ."

This Internal Revenue Service deal which enabled Walter Reuther to settle a $31,000 tax claim for $615 is in sharp contrast with thousands of other cases involving less-fortunate taxpayers whose homes and other personal property have been seized and sold by federal tax collectors insisting on getting every penny due, plus penalties.

Corrupting and Avenging

Until this year, it was impossible for the Internal Revenue Service to examine carefully the great mass of federal income tax returns. The Service had to rely on "spot-checking" — selecting a few returns from all income brackets for careful examination. "Spot-checking" produced an occasional case of disallowance and penalty or prosecution — which was widely publicized to warn and threaten all other taxpayers that the hazard of cheating was greater than the possible gain.

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Under authorization of a 1961 law, however, the Internal Revenue Service is installing a fabulous electronics system for processing tax returns. Every taxpayer is assigned a code number—which enables machines, rather than human beings, to check tax returns for errors and obvious evasions.

This new system of automation will enable the Internal Revenue Service to subject practically all tax returns to searching scrutiny; but automation will not replace the swarms of tax examiners who comb through the records and personal papers of big, or above-average, taxpayers.

The presumption of the tax examiner seems to be that, considering the high cost of government and of living, anyone who has a good income left after taxes *must* be cheating.

The tax examiner has a good government job — liberal fringe benefits and a wage somewhat above the average in private enterprises. But his income is not nearly as big as that of the taxpayers whose records he examines.

As the tax-examiner looks over a big taxpayer's record of expenditure and net gain — and compares these with his own modest income — the thought surely crosses his mind that the world is out of joint. Either the compensation for his abilities and efforts is too little, or the other fellow's compensation is too great.

Thus, under our system, the federal tax collector's eye of suspicion is always upon the most productive citizens in our nation — citizens who generally contribute most to the material well-being of society; citizens whose incomes *are* above average, *because* they have been successful in their business, trade, or profession. And the eye is often jaundiced with envy.

It is widely believed that Internal Revenue agents are directly rewarded for finding errors and fraud in tax returns. This is not literally true; yet there is truth in it.

The tax examiner is not given a cut or percentage of the "recoveries" he makes by detecting and exposing errors; but it is his job to detect and expose. If his record of recoveries is always noticeably lower than that of all other tax examiners, surely his superiors in the tax bureaucracy will wonder about his efficiency.

His superiors have their own careers to consider. If one division of the Internal Revenue Service consistently has a record of detections and recoveries strikingly below that of all others, higher tax officials in Washington may wonder about the efficiency, or integrity, of the whole division. The officials in Washington have career problems, too. If the "enforcement" record of the Internal Revenue Service does not seem to justify the enormous sums which Congress appropriates for enforcement, the whole bureau may have serious problems when its next budget is submitted to Congress. A severe budget reduction could force a reduction in personnel.

Tax examiners with low records of "accomplishment" can endanger not only their own jobs but those of fellow workers: thus, the bureau's *esprit de corps*. In a subtle way, taxpayers who provide the money, and Congress which appropriates it, become the "enemy." Personnel of the Bureau must stand together as a unit to justify, protect, and perpetuate their own jobs.

The biggest taxpayers often have tax accountants and tax lawyers on their own payroll; but many, perhaps most, above-average taxpayers get such services for a fee from outside firms of auditors and tax lawyers. These folks have problems, too. The success of their firms depends on their reputation for effectiveness. An auditing firm which handles income tax matters for many clients must have a reasonably amiable working relationship with local Internal Revenue Service personnel. This

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relationship cannot exist if the auditing firm is contentious and difficult about every detail when the income tax agents examine a client's tax returns.

The income tax agents may question an expense item, or decide that income reported as capital gains should have been reported as regular income and thus taxed at a higher rate. Often, the original decision as to how the item should have been handled for tax purposes was made, not by the taxpayer, but by the auditing firm. Yet, when Internal Revenue questions the decision, the auditing firm frequently recommends that the taxpayer go ahead and pay the additional tax (with penalties), rather than contest it.

Contesting a tax examiner's decision is costly and bothersome — and dangerous. If you irritate the Internal Revenue people unduly, they might "go all out to get you."

If they do "go all out" they can nearly always "get you," regardless of how careful and honest you may have been, because the tax laws are so complicated that no one really understands them, not even the Internal Revenue Service. If they don't "get you," they can harass you half to death with subpoenaes, conferences, interviews, requests for additional records, and so on. The tax examiners are, after all, doing the job they are being paid for when they have a taxpayer in for an all-day conference; and they don't really care how long the case takes, because if they aren't working on one case, they will be working on another. But the taxpayer is taken away from his own work to dance attendance on the tax agents.

All of this seems petty; and it is. Such personal considerations are not supposed to influence the operation of our tax laws; but they do. The result is behavior that violates all the ethical and legal and constitutional principles on which our society is founded.

An internal revenue agent calls a business firm some morning: he wants to look over the books. A shudder of dread runs through the office. The boss is torn between anxiety and anger. He calls his auditor. The auditor is reassuring: it's just a routine check: send him to us; we'll handle it. But ten days later the tax agent is back: certain original records which the auditor does not have — the tax man needs to see them.

The Fourth Article of the American Bill of Rights — the Fourth Amendment to our Constitution — says:

"The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized."

That's clear. This agent of the federal government has no right to rummage through your papers and effects unless he has a warrant listing exactly which papers he wants to see. And he cannot get a search warrant unless some representative of government swears or affirms that he has probable cause to believe that you have violated the law.

You can stand on your constitutional rights; but you had better think twice and call your lawyer before you do it. If you show the tax agent the door and tell him not to darken it again unless he has a warrant, he'll get a *subpoena duces tecum,* listing, not just the "certain papers" that he had asked for, but listing practically all of your books and records — and instructing you to bring them to the federal courthouse for examination. It may take two trucks to haul all the records; it may now take the tax agents two months to complete their examination; and it may stop the operation of your business while the records are away; but no matter: you "asked for it" when you decided to stand on your constitutional rights.

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Few taxpayers handle it this way: most go along to get along. Although they may be seething with indignation, they waive their constitutional rights and treat the tax agent with affability. This puts him in the right frame of mind to be "co-operative." He'll take the records he wants and retire to some inconspicuous desk in a corner of the office and conduct his examination with a minimum of trouble and interruption for the taxpayer.

His "co-operative" attitude is important to the taxpayer during that examination. If our tax laws were simple and had precise meaning, the tax examiner's attitude wouldn't make any difference; but federal tax laws are a jumble of complexity. The taxpayer may have made a tax decision with honorable intentions and expert advice. Indeed, he may have been advised by an agent of the Internal Revenue Service itself to make the decision. But the agent *who examines his books* may interpret the transaction differently. He holds that the taxpayer handled the matter wrong and, therefore, owes an additional $1,000.00 in taxes — plus 6% interest.

The taxpayer calls his auditor. The auditor is likely to say that this is "one of those deals" subject to a variety of interpretations. He thinks the tax examiner's interpretation in this instance is wrong, but he recommends that the taxpayer go ahead and pay, because if he refuses, his refusal will irritate the tax boys; and they can cause him enough trouble to make him wish he had paid that $1000.00 plus penalties.

Most taxpayers give up at this point, but there are a few stubborn ones. They regard this as a matter of principle. If they pay, they will thus, by inference, admit that they had tried to cheat on their income tax. Even if that inference were not present, admitting that their tax decision in this instance was wrong would leave other similar decisions in doubt and open the doors for the Internal Revenue Service to bankrupt the taxpayer with assessments and penalties.

The taxpayer ignores the advice of his auditor and decides to fight the arbitrary ruling of the tax examiner. He calls his tax attorney. But the tax attorney has to get along with the Internal Revenue people too. He handles a lot of tax cases and has a reputation for getting pretty good settlements for his clients, without litigation or too much trouble.

Litigation is not good for his tax law business. The tax laws are so complex that the outcome of any tax case is unpredictable. It would certainly hurt his business to recommend that his client fight a tax ruling — and then lose the case. Moreover, the Internal Revenue people don't like to have their rulings contested. If a tax lawyer has too many legal fights with the Internal Revenue people he will damage his important working relations with them.

The tax lawyer advises the client to go ahead and pay. He may even suggest that he will talk to the tax people and get a reduction — make a better settlement with them. This is often possible.

If the taxpayer has been standing stubbornly on principle, he is outraged at this suggestion of a compromise deal with the Internal Revenue Service. He either owes $1000.00 in taxes or he doesn't. He thinks he doesn't owe. He would damage his principles (and open possibilities for other crippling assessments) just as much by paying $1.00 as by paying $1000.00. He doesn't want a compromise deal. He wants to prove that he was right and that the ruling of the tax examiner is wrong.

He has real difficulties now. He is contemplating a fight against the United States government; and even his own tax lawyer and tax auditor are unsympathetic toward him.

Thus far, the only tax agent he has dealt with is the examiner who made the ruling. The taxpayer feels that if he could talk to some higher officials in the tax bureau, he could

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show them he is right. He asks for an interview; and the tax people grant him the privilege of appearing for a group conference. This is not exactly what the taxpayer had in mind. He wanted to talk to some Internal Revenue official man to man. But this "group conference" sounds formal and rather formidable, very much like a legal hearing.

He reasons that if he goes to this thing he had better take his lawyer along, because he is a simple taxpayer who just knows how to run a business: he doesn't know the jargon of bureaucracy and of the legal profession. But he finds that he cannot take his lawyer to the group conference unless he gives the lawyer the power of attorney to make binding decisions for him. If he did this, his lawyer could decide during the conference to make a deal with the tax people; and the taxpayer would be legally bound by that decision. His lawyer has already said he wants to make a deal. The taxpayer is afraid to take his own lawyer to the group conference with tax officials. He goes alone.

At the group conference with the tax people, he finds an attitude which is a mixture of indifference and hostility. The tax officials there may privately feel that the tax examiner did make a wrong and stupid ruling, but they can't admit that to the "enemy." They have *esprit de corps;* they must stick together to protect their own.

Soon after the conference, the taxpayer gets a notice that if he doesn't pay, the tax people will issue an official judgment with penalties and attach everything he has until the total is paid. The taxpayer takes his case to the Appellate Division in the local Internal Revenue Service office which upholds the ruling of the original tax examiner.

The stubborn taxpayer decides to fight all the way, to take his case into federal district court — not into a tax court which is really an administrative agency presided over by members of the very bureaucracy which is harassing him.

The taxpayer finds that he cannot sue the government in federal court unless the government permits itself to be sued; and in a case like this, the government won't permit itself to be sued unless the taxpayer pays, under protest, the total amount which the Internal Revenue Service has assessed, and then files claim for a rebate.

If the taxpayer has enough determination and resources, he can fight through all the necessary administrative procedures and get his case into a federal court; but he arrives there with a strong presumption of guilt against him: he has already been declared guilty after formal hearings before administrative tribunals.

If he loses in federal court, the penalties and costs are crushing. If he wins, he merely gets back (with 6% interest) the amount which government illegally took away from him.

Entrenched Interests

Although it is obvious that the present taxing system is oppressive, inequitable, and tyrannical, the most powerful forces in our society have a vested interest in perpetuating it.

The most powerful entrenched interest is the federal bureaucracy itself. The government uses the money of the people to propagandize the people into believing that the income tax system is indispensable. Some who cannot be brainwashed into acceptance, can be harassed into silence.

Tax-exempt foundations and colleges are second only to the federal government in influence on the thinking of the people; and these powerful opinion-formers also have a vested interest in the oppressive tax system which threatens to strangle the nation.

Tax experts have devised complicated schemes by which a wealthy man can actually

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save money by giving to tax-exempt organizations. Consequently, many of the great philanthropies which buy fame and respectability for individuals or corporations are legal tax-avoidance schemes. They remove from taxation mammoth sums of money, placing this money in the hands of tax-exempt organizations whose officials often know little about (or are actively hostile toward) the profit-motivated free enterprise system which produced the funds in the first place.

Co-operatives are another entrenched interest which would lose special privilege if the Income Tax Amendment were repealed. Initially, co-operatives were combinations of small operators (farmers, merchants, and so on) who merely pooled their resources to compete with giant competitors. Some co-operatives still exist for that laudable purpose; but many have become big businesses enjoying special tax advantages over their competitors.

Unions, being tax-exempt, have a vested interest in the present taxing system. Even business enterprises owned and operated by unions are sometimes exempt from taxes which rival businesses must pay.

Most of these rich and powerful tax-exempt organizations have become clamorous lobbies for more taxing and spending whose burden must, necessarily, fall on taxpayers of low and modest income with no means of devising legal tax-avoidance, or tax-exemption schemes.

Withholding Is the Key

The corrupting and despoiling federal income-tax system cannot be reformed. It must be scrapped, and replaced with an equitable system.

Constitutionalists have been working toward this end for years, and have made headway in arousing the public to a realization that the Income Tax Amendment must be repealed; but their major problem is in reaching millions of wage-earners who, in the end, carry most of the crushing tax load. The withholding of federal taxes from wages and salaries, before the wage earner gets his pay, conceals from a majority of taxpayers the great and needless burden they are carrying.

If Congress would just repeal the law that "authorizes" withholding, tens of millions of American wage earners would come to an abrupt realization of what *they* are being forced to pay for extravagance, waste, corruption, and subsidies to foreign dictators. Repeal of the inequitable income-tax system would soon follow.

As pointed out last week, United States Representative Bruce Alger introduced HR 11492, on April 30, 1962, to eliminate the withholding of income tax from wages and salaries. Mr. Alger says:

"We have lost all control over spending in this country. . . . Since the great burden of taxes is borne by the so-called little or modest income folks, I think it is high time that they found out how much taxes they are paying. In order to do that, I think we ought to let them pay their own. . . .

"It seems to me timely and sensible that the American citizens demand a halt to the continuation of the *tax-tax, spend-spend, elect-elect* policy. This repeal of the withholding tax will be the means of beginning the necessary and agonizing reappraisal."

Next week, we will suggest an equitable federal taxing system. No equitable system can be adopted, however, until the Income Tax Amendment is repealed and the present system outlawed. This cannot be accomplished until millions of taxpayers and voters are in the mood to demand it. The quickest and surest way to get them in that mood is to eliminate the withholding of income tax from salaries.

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Hence, every American who cares should write his United States Representative — and get others to write — urging maximum *support for* Bruce Alger's HR 11492.

Everyone who cares should also write both of his United States Senators demanding *defeat of* the Revenue Bill of 1962 (HR 10650) which extends the withholding system to include income on investments, dividends, and interest earnings (see this *Report,* "Withholding Tax — Part I," April 30, 1962; and "Withholding Tax — Part II," May 7, 1962).

Corrections

In the April 23, 1962, issue of this *Report,* we recorded a "Liberal" vote for Representative Donald C. Bruce (Republican, Indiana) and a "Conservative" vote for Representative J. Edward Roush (Democrat, Indiana) on the Manpower Development and Training Act. We erred. Mr. Bruce voted "Conservative" on the Manpower Bill; Mr. Roush voted "Liberal."

In both the March 5 and April 23 (1962) issues of this *Report,* we incorrectly listed Representative Catherine May (Republican, Washington) and Representative William H. Bates (Republican, Massachusetts) as Democrats.

We offer our apologies for these clerical errors.

In the April 23, 1962, issue we recorded Representative Edith Green (Democrat, Oregon) as taking no stand: (1) on HR 10162, which authorized a 2-billion-dollar loan to the International Monetary Fund; and (2) on HR 10700, which appropriated money for continuation and expansion of the Peace Corps. Our recording was accurate; but Mrs. Green has let us know that she was *for* both of these "Liberal" bills. Mr. A. Wesley Barthelmes, Jr., Administrative Assistant to Representative Green, wrote us a note, saying:

"I notice in your congressional rollcall listing in your April 23 issue, you are lacking Rep. Edith Green's position on the International Monetary Fund authorization and the Peace Corps financing. Just so you know that Mrs. Green continues to disagree with your extremist position, I inform you that you may place an "L" under columns 6 and 7 — she is heartily in favor of both. I want your records to be complete."

WHO IS DAN SMOOT?

Dan Smoot was born in Missouri. Reared in Texas, he attended SMU in Dallas, taking BA and MA degrees from that university in 1938 and 1940.

In 1941, he joined the faculty at Harvard as a Teaching Fellow in English, doing graduate work for the degree of Docror of Philosophy in the field of American Civilization.

In 1942, he took leave of absence from Harvard in order to join the FBI. At the close of the war, he stayed in the FBI, rather than return to Harvard.

He worked as an FBI Agent in all parts of the nation, handling all kinds of assignments. But for three and a half years, he worked exclusively on communist investigations in the industrial midwest. For two years following that, he was on FBI headquarters staff in Washington, as an Administrative Assistant to J. Edgar Hoover.

After nine and a half years in the FBI, Smoot resigned to help start the Facts Forum movement in Dallas. As the radio and television commentator for Facts Forum, Smoot, for almost four years spoke to a national audience giving both sides of great controversial issues.

In July, 1955, he resigned and started his own independent program, in order to give only one side — the side that uses fundamental American principles as a yardstick for measuring all important issues.

If you believe that Dan Smoot is providing effective tools for those who want to think and talk and write on the side of freedom, you can help immensely by subscribing, and encouraging others to subscribe, to *The Dan Smoot Report.*

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